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Effective board evaluations can drive better board performance. So how are today’s leading boards evolving their evaluations to enhance effectiveness, and what are their companies communicating to stakeholders about their board evaluation processes?

Board evaluation practices

Leading the evaluation process

Leadership is key in designing and implementing an effective evaluation process that objectively elicits valuable and candid director feedback about board dynamics, operations, structure, performance and composition.

A strong majority, 73%, of 2019 Fortune 100 proxy filers disclosed that their corporate governance and nominating committee performed the evaluation process either alone or together with the lead independent director or chair – a modest increase from 69% in 2018. These companies also disclosed that evaluation leaders did or could involve others in the evaluation process, including third parties, internal advisors and external legal counsel. Twenty-seven percent of Fortune 100 proxy filers disclosed using or considering the use of an independent third party to facilitate the evaluation at least periodically – an increase from 22% in 2018.
Observations about Fortune 100 company board evaluation practices

<table>
<thead>
<tr>
<th>Observation</th>
<th>2018 % of total</th>
<th>2019 % of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Evaluation process is ongoing</td>
<td>9%</td>
<td>18%</td>
</tr>
<tr>
<td>Performed individual director self-evaluation, in addition to board and committee evaluation</td>
<td>24%</td>
<td>39%</td>
</tr>
<tr>
<td>Conducted peer evaluations</td>
<td>10%</td>
<td>25%</td>
</tr>
<tr>
<td>Used or considered using a third party at least periodically to facilitate the evaluation</td>
<td>22%</td>
<td>27%</td>
</tr>
<tr>
<td>Used both questionnaires and individual director interviews to conduct the evaluation</td>
<td>26%</td>
<td>29%</td>
</tr>
<tr>
<td>Provided board evaluation disclosures in their proxy statement</td>
<td>93%</td>
<td>92%</td>
</tr>
<tr>
<td>Identified in the proxy statement general topics covered in the evaluation</td>
<td>40%</td>
<td>49%</td>
</tr>
<tr>
<td>Disclosed in the proxy statement general actions taken as a result of the evaluation</td>
<td>21%</td>
<td>25%</td>
</tr>
</tbody>
</table>

1 Data based on the most recent proxy statements available for the 86 public companies on the 2018 Fortune 100 list.
2 Data based on the most recent proxy statements available for the 79 public companies on the 2019 Fortune 100 list.

“Boards are adopting more practices for effective evaluations, such as individual director evaluations, peer evaluations and use of third parties to facilitate the evaluation.”
Evaluation of individual directors and peers

Board and committee evaluations have long been required of all public companies listed on the New York Stock Exchange. Today, board and committee evaluations are standard practice for all public companies.

Boards are continuing to expand their evaluation process to include individual director self- and peer evaluations. Approximately 40% of 2019 Fortune 100 proxy filers disclosed that they included individual director self-evaluation along with board and committee evaluation, up from 25% in 2018. Twenty-five percent of 2019 Fortune 100 proxy filers disclosed that they conducted peer evaluations, more than double the 10% in 2018.

Prioritizing and disclosing evaluation topics

Board, committee and individual director evaluation topics should be customized and prioritized to elicit valuable, candid and useful feedback on board dynamics, operations, structure, performance and composition. Relevant evaluation topics and areas of focus should be drawn from:

- Observations relevant to board dynamics, operations, structure, performance and composition
- Company reputation, culture, strategy, human capital management, risk management and overall performance
- Investor and stakeholder engagement on board composition, performance and oversight
- Analysis of board and committee minutes and meeting materials
- Board governance documents, such as corporate governance guidelines, committee charters, director qualification standards, as well as company codes of conduct and ethics

Approximately half of 2019 Fortune 100 proxy filers disclosed the general topics covered by the evaluation, up from 40% in 2018.

Conducting the evaluation: questionnaires and interviews

About 30% of 2019 Fortune 100 proxy filers disclosed using both questionnaires and interviews in their evaluation process – up from 26% in 2018. Fifteen percent disclosed use of questionnaires only – consistent with 2018, and 13% disclosed use of interviews only – slightly down from 15% in 2018.

Using a third-party facilitator

Use of third-party experts, such as governance advisory firms or external counsel, to facilitate the evaluation process is increasing. Twenty-seven percent of 2019 Fortune 100 proxy filers disclosed having a third-party facilitate their evaluation at least periodically, typically stated as every two or three years, up from 22% in 2018.

Intra-year evaluations and ongoing feedback

Board evaluations generally are performed annually. Board performance is enhanced when feedback is delivered more promptly – either in real time or over a short-term period, as observed.

This year, 18% of proxy filers in the 2019 Fortune 100 disclosed that they carry out phases of the evaluation process on an ongoing basis, at every in-person meeting, quarterly, biannually or otherwise during the year – about double the number in 2018.

Disclosing the evaluation process and evaluation results

A vast majority, 93%, of 2019 Fortune 100 proxy filers provide at least some disclosure about their evaluation process, nearly the same as in 2018. We continue to observe variances in the scope and details of the disclosures.

About 25% of 2019 Fortune 100 proxy filers disclosed, at a high level, actions taken as a result of their board evaluation, up from about 20% in 2018.
Conclusion

Investors, regulators, other company stakeholders and governance experts are continuing to challenge boards to examine and explain board performance and composition. Indeed, many stakeholders note board effectiveness and composition as a top priority and foundation for long-term value creation and sustainability. Boards are listening. They are enhancing their evaluation practices; addressing the need for increased board diversity, expertise and effectiveness; and better communicating their work to investors and other stakeholders. Continuous improvement is the new mantra – for boards, and also management, talent and companies themselves. Boards should embody – and their disclosures should reflect – this mantra.

Questions for the board to consider

• Has the most recent evaluation process enabled the board and individual directors to identify actions to optimize board and director performance and board composition?

• Does the evaluation process provide validation to each director that he or she is the right director at the right time for the right company?

• Does the board as a whole and each director have a common and clear understanding of the term “effectiveness” as applied to the board as a whole, its committees and each director individually?

• Has the board formulated clear goals, objectives and standards for itself, its committees and each director that can be referenced during and outside of the evaluation process? If the board has director qualification standards, should they be expanded in more specific ways to include standards and requirements that each director must consistently meet to earn renomination?

• Does the evaluation process include components that occur on a biannual, quarterly and/or real-time basis? If not, why not?

• Is the evaluation process appropriately synergized with the board’s annual governance review, orientation and education programs, director nomination process, succession planning and stakeholder engagement programs?

“Many stakeholders note board effectiveness and composition as a top priority and foundation for long-term value creation and sustainability.”
Cybersecurity attacks are among the gravest risks that businesses face today. The 2019 EY CEO Imperative Survey found that CEOs ranked national and corporate cybersecurity as the top global challenge to business growth and the global economy.

In this environment, stakeholders want to better understand how companies are preparing for and responding to cybersecurity incidents. They also want to understand how boards are overseeing these critical risk management efforts. Some of the answers can be found in public disclosures.

The U.S. Securities and Exchange Commission (SEC) issued guidance in 2018 promoting clearer and more robust disclosure about cybersecurity risks and incidents and how boards discharge their cybersecurity risk oversight responsibility. Our 2018 Cybersecurity disclosure benchmarking report explored how companies were responding to this guidance.

We undertook the same research this year to help inform stakeholders of emerging trends and developments. We analyzed three areas of cybersecurity-related disclosures in the proxy statements and Form 10-K filings of Fortune 100 companies from 2018-19: board oversight (including risk oversight approach, board-level committee oversight, and director skills and expertise), statements on cybersecurity risk, and risk management (including cybersecurity risk management efforts, education and training, engagement with outside security experts and use of an external advisor). We found that many companies are enhancing their cybersecurity disclosures, with the most significant changes related to board oversight practices.

We also found that the depth and nature of these disclosures vary widely, and do not necessarily capture the entirety of a company’s cyber-risk management and oversight activities. For example, only a few companies disclosed they are obtaining an assessment of their cybersecurity risk management program from an independent third party or conducting tabletop exercises (i.e., breach simulations) to enhance cyber-incident preparedness by the board and C-suite. These are practices we are routinely observing in the market.
Our market observations

The EY Center for Board Matters frequently conducts education and insight sessions for boards. Based on these meetings and the work being done by our cybersecurity advisors around the globe and across industries, we have identified the following leading practices for overseeing cybersecurity risks:

- Having unfiltered board discussions with the chief information security officer (CISO) in executive sessions
- Gaining insights into how management is validating the operational effectiveness of its cybersecurity risk management program
- Regularly infusing cyber in boardroom conversations with all C-suite executives and division leaders to help create accountability for their role in supporting the cybersecurity environment
- Asking questions about cybersecurity impacts when contemplating any new product, initiative, partnership or business deal, and overseeing that cyber resiliency is embedded into the foundation of company practices and process (i.e., trust by design)
- Upskilling the full board via concentrated cybersecurity education and periodic training sessions with outside experts, certification courses and peer-to-peer director exchanges
- Overseeing that a third party is periodically evaluating the design and effectiveness of the company’s cybersecurity risk management program, and engaging directly with that third party to help challenge internal bias
- Overseeing, and periodically participating in, tabletop exercises and simulations as part of the company’s cybersecurity incident response and recovery planning

SEC guidance

The SEC’s 2018 Commission-level guidance, which reinforced and built on the SEC staff’s 2011 cybersecurity guidance, clarified companies’ obligations to disclose cybersecurity risks, material breaches and the potential impact of the breaches on business, finances and operations – the goal being to enable investors to make more risk-informed investment decisions. The guidance reminded companies that a number of existing SEC disclosure requirements could require disclosure of cybersecurity matters, including description of the business, legal proceedings, MD&A, board role in risk management and risk factors.

It expanded the prior guidance by highlighting two new topics: (i) the importance of strong disclosure controls and procedures to enable timely and accurate disclosures of cybersecurity risks and incidents, and (ii) insider trading prohibitions related to cybersecurity incidents. Although the SEC reiterated its expectation that companies provide timely disclosure of cybersecurity risks and incidents that are material to investors, the guidance clarifies that companies need not make disclosures that could compromise their cybersecurity efforts, and acknowledges that an ongoing investigation by law enforcement of a cybersecurity incident may affect the scope of the disclosure about the incident.

“National and corporate cybersecurity was ranked No. 1 by CEOs as the biggest challenge for the global economy in the next 5-10 years.”

EY CEO Imperative Study

1 See also How the SEC views cybersecurity disclosures and board’s oversight role.
Since the 2018 guidance was issued, SEC Chairman Jay Clayton has made public statements emphasizing the importance of cybersecurity disclosures.\(^2\) SEC Director of the Division of Corporation Finance William Hinman also has discussed the need for companies to comply with the guidance and noted that companies are responding to the guidance, as the SEC staff is seeing fewer boilerplate cybersecurity-related disclosures.\(^3\) The Commission staff also has asked questions about the sufficiency of cybersecurity disclosures in comment letters to issuers.

The SEC staff looks at and comments on cybersecurity-related disclosures as part of its regular reviews of public company filings. The staff also monitors news reports of cyber breaches to assist in this process.\(^4\) The SEC staff has said it does “not second-guess good faith exercises of judgment about cyber-incident disclosures. But we have also cautioned that a company’s response to such an event could be so lacking that an enforcement action could be warranted.”\(^5\) One such case has already been brought.\(^6\)

**Investor perspectives**

Most investors consider cybersecurity to be a critical component of risk oversight and are engaging with portfolio companies to better understand how cybersecurity risk is governed and managed. We heard this consistently in late 2018 in conversations with governance specialists from more than 60 institutional investors representing over US$32 trillion in assets under management.

As part of our annual EY Center for Board Matters investor outreach, we asked investors about the top risk issues they are raising in their engagements with companies, and 61% said cybersecurity, regardless of sector, was among those elevated risk issues, even though investors characterize cyber risk as a pervasive and standard risk impacting all companies. Some of the key themes we heard from those conversations were:

- An interest in understanding how boards are structuring oversight (i.e., is a committee or the full board charged with that responsibility?)
- How directors are developing competence around and staying up to speed on cyber issues
- Who in management is reporting to the board and how often
- Key features of how management is addressing cyber risk
- Interest in data privacy issues and compliance with new privacy laws and regulations

While some investors said they are focused on companies where a cyber incident has occurred, they also said that given the current environment where cybersecurity attacks are inevitable, they are specifically focused on companies’ response and recover mechanisms.

\(^2\) SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks, speech by SEC Chairman Jay Clayton, 6 December 2018; EY publication, 2018 AICPA Conference on Current SEC and PCAOB Developments.
\(^3\) Ibid.
\(^4\) Ibid.
\(^5\) Altaba, Formerly Known as Yahoo!, Charged With Failing To Disclose Massive Cybersecurity Breach; Agrees To Pay $35 Million, SEC press release, 24 April 2018.
\(^6\) Ibid.
What we found

We conducted an analysis of cybersecurity-related disclosures in the proxy statements and annual reports on Form 10-K of the 82 companies on the 2019 Fortune 100 list that filed those documents in both 2018 and 2019 through 5 September 2019. The analysis was based on cybersecurity-related disclosures on the following topics:

- Board oversight, including risk oversight approach, board-level committee oversight, and director skills and expertise
- Statements on cybersecurity risk
- Risk management, including cybersecurity risk management efforts, education and training, engagement with outside security experts and use of an external advisor

Overall, we observed modest year-over-year increases across most of the disclosures tracked, though the depth and company-specific nature of the disclosures continued to vary widely, including the level of detail. This reveals continued opportunity for enhancement in how risk management activities and responsibilities, response preparedness and board oversight around cybersecurity issues are communicated.

The most significant changes relate to the area of board oversight, including risk oversight approach, board-level committee oversight, and the identification of director skills and expertise, as well as officers reporting to the board on cybersecurity. Specifically:

- 89% of companies disclosed a focus on cybersecurity in the risk oversight section of their proxy statements, up from 80% last year.
- More boards assigned cybersecurity oversight to non-audit committees — 28% this year up from 21% in 2018.
- A portion of these, 9% overall, assigned cyber responsibilities to both a non-audit committee and the audit committee. Most companies, 56% overall, assigned cybersecurity oversight to the audit committee alone. Some companies, 10% overall, indicated that the full board retained cybersecurity oversight, and a small number, 6% overall, did not explicitly disclose how they allocate oversight.
- Only a few of these boards moved cybersecurity oversight responsibilities from the audit committee to another committee; in most cases, cybersecurity oversight responsibilities were newly assigned to a non-audit committee.
- More than half (54%) included cybersecurity as an area of expertise sought on the board or cited in a director biography, up from 40% last year.
- 33% identified at least one “point person” from management (e.g., the CISO or the chief information officer) who reports to the board, up from 26% last year.

The percentage of companies that disclosed the use of an external independent advisor regarding cybersecurity matters held fairly steady at 12% in 2019 versus 13% last year. Nine percent stated that their preparedness includes simulations, tabletop exercises, response readiness tests or independent assessments.
## Fortune 100 company cybersecurity disclosures 2018–19

<table>
<thead>
<tr>
<th>Topic</th>
<th>Disclosure</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Board oversight</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Risk oversight approach</td>
<td>Disclosed a focus on cybersecurity in the risk oversight section of the proxy statement</td>
<td>80%</td>
<td>89%</td>
</tr>
<tr>
<td>Board-level committee oversight*</td>
<td>Disclosed that at least one board-level committee was charged with oversight of cybersecurity matters</td>
<td>78%</td>
<td>84%</td>
</tr>
<tr>
<td></td>
<td>Disclosed that the audit committee oversees cybersecurity matters</td>
<td>62%</td>
<td>65%</td>
</tr>
<tr>
<td></td>
<td>Disclosed oversight by a non-audit-focused committee (e.g., risk, technology)</td>
<td>21%</td>
<td>28%</td>
</tr>
<tr>
<td>Director skills and expertise</td>
<td>Cybersecurity included among areas of expertise sought on the board and/or cited in at least one director biography</td>
<td>40%</td>
<td>54%</td>
</tr>
<tr>
<td></td>
<td>Cybersecurity included among the areas of expertise sought on the board</td>
<td>23%</td>
<td>32%</td>
</tr>
<tr>
<td></td>
<td>Cybersecurity cited in at least one director biography</td>
<td>30%</td>
<td>40%</td>
</tr>
<tr>
<td>Management reporting structure</td>
<td>Provided insights into management reporting to the board and/or committee(s) overseeing cybersecurity matters</td>
<td>52%</td>
<td>54%</td>
</tr>
<tr>
<td></td>
<td>Identified at least one “point person(s)” (e.g., the chief information security officer or chief information officer)</td>
<td>26%</td>
<td>33%</td>
</tr>
<tr>
<td>Management reporting frequency</td>
<td>Included language on frequency of management reporting to the board or committee(s), but most of this language was vague</td>
<td>39%</td>
<td>43%</td>
</tr>
<tr>
<td></td>
<td>Disclosed reporting frequency of at least annually or quarterly; remaining companies used terms like “regularly” or “periodically”</td>
<td>12%</td>
<td>16%</td>
</tr>
<tr>
<td><strong>Statements on cybersecurity risk</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Risk factor disclosure</td>
<td>Included cybersecurity as a risk factor</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Risk management</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cybersecurity risk management efforts</td>
<td>Referenced efforts to mitigate cybersecurity risk, such as the establishment of processes, procedures and systems</td>
<td>82%</td>
<td>89%</td>
</tr>
<tr>
<td></td>
<td>Referenced response planning, disaster recovery or business continuity considerations</td>
<td>49%</td>
<td>55%</td>
</tr>
<tr>
<td></td>
<td>Stated that preparedness includes simulations, tabletop exercises, response readiness tests or independent assessments</td>
<td>9%</td>
<td>9%</td>
</tr>
<tr>
<td>Education and training</td>
<td>Disclosed use of education and training efforts to mitigate cybersecurity risk</td>
<td>18%</td>
<td>26%</td>
</tr>
<tr>
<td>Engagement with outside security community</td>
<td>Disclosed collaborating with peers, industry groups or policymakers</td>
<td>6%</td>
<td>11%</td>
</tr>
<tr>
<td>Use of external advisor</td>
<td>Disclosed use of an external independent advisor</td>
<td>13%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Percentages based on total disclosures for companies. Data based on the 82 companies on the 2019 Fortune 100 list that filed Form 10-K filings and proxy statements in both 2018 and 2019 through 5 September 2019.

*Some companies designate cybersecurity oversight to more than one board-level committee.
Risk oversight approach

The depth of these disclosures varies widely. Companies on one end of the spectrum only listed cybersecurity among a variety of specific risks incorporated in the board’s risk oversight. Companies on the other end provided more in-depth information regarding how the board exercises its cybersecurity risk oversight responsibilities. For example, companies in the latter group disclosed information about how often management is reporting to the board, which member(s) of the management team is meeting with the board and some of the specific topics discussed.

Director skills and expertise

This year, 33 companies cited cybersecurity in the biography of at least one director, up from 25 companies last year. The meaning of this data is difficult to interpret. For example, a few companies explicitly cited cybersecurity experience in certain director biographies one year but not the other. In sum, the disclosures may at least indicate that companies are paying more attention to noting director experience or expertise in cyber.

Response readiness simulations and tabletop exercises

Nine percent of companies stated that their cybersecurity preparedness includes simulations, tabletop exercises, response readiness tests or independent assessments. This 9% is weighted to the independent assessments; of the few companies that specifically disclose that they are performing simulations, drills or response readiness exercises at the management level, none disclosed whether the board is involved in these exercises.

Simulations are a critical risk preparedness practice that EY and others believe boards should prioritize. Among other critical benefits, such exercises help companies develop and practice action plans related to data privacy issues. Cyber breaches can – and often do – result in the loss of personal data. These events require compliance with a host of complex state and federal laws (all of which call for prompt notice to states, regulators and affected persons) and may require compliance with the laws of non-US jurisdictions. Preparation is key to promoting compliance.

If companies are performing cybersecurity breach simulations, they should, as a best practice, disclose that, and if not, boards should make this an agenda item in the near term.

Use of external independent advisor

This year, the portion of companies that disclosed the use of an external independent advisor to support management held fairly steady at 12% versus 13% last year. Among the 10 companies that made the disclosure in 2019, only one made clear that the board meets directly with the independent third party. Our research did not identify any discussion of the scope of the external assessments provided or whether an attestation opinion was obtained utilizing the American Institute of Certified Public Accountants’ System and Organization Controls for Cybersecurity framework, which provides for an entity-wide examination of the company’s cyber risk management program.

Boards of directors

Boards are continuing to increase their engagement on the subject. The National Association of Corporate Directors (NACD) and the Internet Security Alliance first issued The Director’s Handbook on Cyber-Risk Oversight in 2014, outlining five core principles for board-level cybersecurity oversight. NACD and ISA are expected to issue a third edition of the handbook in 2020, capturing the evolution of the threat environment and providing additional tools for directors.

In spring 2019, Ernst & Young LLP hosted a series of gatherings bringing together board members for discussions on the latest challenges and leading practices in overseeing cybersecurity risk. We engaged with more than 100 directors who collectively represent more than 200 public companies. We issued a report, What boards are doing today to better oversee cyber risk, to share insights and takeaways from the conversations with these directors.
Two of the key recommendations from this group were that boards should:

- Set the tone that cybersecurity is a critical business issue
- Stay attuned to evolving board and committee cybersecurity oversight practices and disclosures, including asking management for a review of the company’s cybersecurity disclosures with peer benchmarking over the last two to three years

**US public policy environment**

In response to a growing number of high-profile cybersecurity attacks and breaches on US companies, Congress has increased its oversight and engagement on cybersecurity disclosure and cyber-risk management.

Legislators also have introduced legislation, including the [Cybersecurity Disclosure Act of 2019](https://www.govtrack.us/congress/bILLS/116/hr12810), for the second straight Congress. The bipartisan bill, introduced by Senator Jack Reed (D-RI) and Rep. Jim Himes (D-CT), and supported by Senator Susan Collins (R-ME), would direct the SEC to issue final rules requiring a registered public company to disclose in its annual report or annual proxy statement whether any member of its board has expertise or experience in cybersecurity. Differing from the bill introduced in previous legislative sessions, this version of the bill text permits a company to disclose why having cyber expertise on the board is not necessary due to other cybersecurity protocols put in place by the company.

While this bill and other proposed cybersecurity bills have failed to gain momentum in Congress (passing in the House and not receiving a Senate vote), interest in and scrutiny of how companies are managing cybersecurity risks will remain a key focus of Congress and other policymakers in Washington.

**Conclusion**

Recognizing the threat that cybersecurity attacks pose to companies, consumers and our capital markets, a variety of stakeholders want to understand how companies plan for and respond to cybersecurity incidents—and how the board conducts oversight of these activities. This understanding is increasingly critical for building stakeholder confidence and trust as the cybersecurity risk landscape evolves and as technological innovations raise the stakes for data privacy and protections.

Public disclosures present an opportunity for companies to further this understanding and demonstrate engagement. By examining how disclosures are evolving and sharing perspectives and insights based on our market engagement, companies can identify opportunities for enhancement of both communications and practices related to this vital matter.

“As our society increasingly relies on technology, businesses across all sectors of the economy must prioritize cybersecurity. A single cyberattack can cripple even the most sophisticated firms, and the public has a right to know whether companies are focused on preventing cybersecurity threats.”

Senator Doug Jones (D-AL)

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Questions for the board to consider

- Is the board allocating sufficient time on its agenda, and is the committee structure appropriate, to provide effective oversight of cybersecurity?
- Do the company’s disclosures effectively communicate the rigor of its cybersecurity risk management program and related board oversight?
- Is the board communicating with C-suite executives beyond the CISO to gain insights into potential business impacts of cyber incidents, and how cybersecurity governance is integrated across all divisions?
- What resources is the board using to enhance its competency on cybersecurity topics and understand emerging threats?
- How is the board getting a pulse on the company’s culture with respect to cybersecurity?
- Does management reporting to the board include: (1) metrics that report on the health of the cybersecurity risk management program, including visibility into the effectiveness of the program, and (2) the results of cyber-breach simulations? Does the board periodically participate in those drills?
- Does the board understand the scope of work performed through any independent third-party assessments, and is the board having direct dialogue with that third party?
- Has the board considered the value of obtaining a cybersecurity attestation opinion to build confidence among key stakeholders?
How and why human capital disclosures are evolving

The talent paradigm is shifting. A company’s intangible assets, which include human capital and culture, are now estimated to comprise, on average, 52% of a company’s market value.\(^1\) At the same time, the nature of work is rapidly evolving, new generations are reshaping the workforce and businesses are redefining long-term value and corporate purpose through a stakeholder lens.

In this era of disruption, talent and culture have leapt to the forefront of thinking around enabling strategy and innovation and creating long-term value. Accordingly, human capital has rapidly emerged as a critical focus area for stakeholders. There is a clear and growing market appetite to understand how companies are managing and measuring human capital, demonstrated by:

- Comments received by the U.S. Securities and Exchange Commission (SEC) on human capital matters, as articulated in the August 2019 proposed rule amendments to revise current business disclosure requirements
- Influential investors such as BlackRock and State Street Global Advisors making human capital and company culture engagement priorities
- Market-driven frameworks such as the Global Reporting Initiative, the Embankment Project for Inclusive Capital and the Sustainability Accounting Standards Board (SASB) identifying human capital as a key value driver

Advancing disclosures to keep pace with this transformational view of human capital will be a journey. To better understand where companies are on this journey, we reviewed the proxy statements of Fortune 100 companies to see how leading companies are disclosing their governance and management of human capital.

We found that Fortune 100 company proxy disclosures reflect early-stage efforts to meet growing demands for better communications around the management and governance of human capital and culture. Two key observations stand out from our analysis and are explored in greater detail. One, many companies voluntarily highlight management’s general efforts around certain human capital issues (e.g., diversity and inclusion or broader workforce compensation). However, these disclosures often do not identify key performance indicators (KPIs) or quantify them. Two, many companies broadly address board oversight of human capital.

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management or culture, and more assign related committee oversight responsibilities, but the depth and clarity of these disclosures vary and may not provide a complete picture of the board's governance in this important area.

Of course, proxy statements are not the only vehicle for human capital or culture disclosures, as many companies disclose such information in corporate social responsibility (CSR) or sustainability reports and other public disclosures that may or may not be filed with the SEC. Proxy statements are, however, an increasingly important tool for shareholder and other stakeholder engagement and a key source of information about the board's governance philosophy and approach.

In addition to outlining key findings from our review of Fortune 100 proxy statements, this report also highlights emerging frameworks and KPIs for measuring and reporting on human capital and culture to help guide companies as they evolve their practices and disclosures. Further, it provides an overview of related regulatory developments and increasing investor engagement on human capital and culture to reflect the continuing role of stakeholders in advancing human capital disclosures.

What we found: the current landscape for proxy disclosures on human capital and culture

As human capital and culture increasingly become priorities for boards and management, companies and others are in the early stages of identifying the best ways to address this priority, both practically and in disclosures. The workforce is changing rapidly due to technology and increased competition for talent—particularly as talent is more attracted to companies that have a clear purpose, strong culture and respected reputations. As companies navigate these changes, they can benefit and enhance their reputation with stakeholders by examining the activities that can help them attract, retain and motivate the best talent, developing KPIs around those activities and disclosing those KPIs that best indicate value creation or enhancement.

Overall, we found that current voluntary proxy disclosures on human capital and culture reflect this emerging stage of development and underscore leading companies’ efforts to proactively and voluntarily address topics of stakeholder interest.

We observe opportunity for enhancing these disclosures to provide clarity on how companies are prioritizing human capital and culture as long-term strategic assets, and how board oversight is advancing and protecting related value creation.

This is based on our analysis of human capital and culture-related disclosures in the proxy statements of 82 companies on the 2019 Fortune 100 list available as of 5 September 2019.
Disclosures relating to human capital and culture programs

While proxy statements may not be the primary vehicle for human capital or culture disclosures (which are often included in CSR or sustainability reports), they do communicate the board’s governance approach and are increasingly used as a communication tool around areas of shareholder interest, including human capital. Indeed, we found that many companies voluntarily highlighted commitments to and/or initiatives and goals with respect to human capital and culture. Only a subset of these, however, disclosed any KPIs, with fewer quantifying them. The following data and observations reflect the human capital topics, and any related KPIs, most often highlighted by companies.

Workforce diversity – half of Fortune 100 companies highlighted commitments and efforts to enhance diversity and inclusion. Key themes of these disclosures included initiatives to empower women and minorities and bring them into leadership positions, diversity statistics and recruitment goals around diverse talent, employee affinity groups, supplier diversity initiatives, collaborations with diversity organizations, and external rewards and recognition.

• Just under a third of the companies that discussed workforce diversity provided some measure of workforce diversity data (e.g., percentage of women and/or people of color across the global or US workforce, at the management level, in leadership positions or across incoming hires).

Workforce compensation – around a third of companies highlighted key practices or developments related to compensation of the broader workforce. Most of these companies highlighted pay equity, including efforts to identify and eliminate pay gaps for women and minorities. Other key themes of these disclosures were minimum wage increases and general statements around the company’s compensation approach.

• Around 40% of the companies that discussed workforce compensation disclosed specific performance data around pay equity beyond the required CEO pay ratio. That information generally included the pay ratio for female to male employees, the pay ratio for minority to nonminority employees and, in some cases, a measure of the adjustments made to help close the gap. A quarter of the companies reported a specific new minimum or starting wage (usually $15 per hour but in some cases $11 per hour).

Culture initiatives – 22% of companies mentioned some of the ways they are embedding or measuring culture beyond compliance with codes of conduct or executive pay considerations. Some of the practices highlighted include employee surveys and benchmarking reports, employee town halls, unconscious bias trainings, leadership team events, and the inclusion of culture-related messaging and feedback via onboarding processes, performance reviews and exit surveys.

• Half of the companies that discussed culture initiatives said that they use employee surveys to measure culture. Some of the other KPIs mentioned included diversity hires, employee engagement, turnover and issues escalation resolution. With limited exceptions, the companies did not provide quantitative results for their disclosed KPIs.

Workforce health and safety – 22% of companies discussed commitments, initiatives or benefit programs related to workforce health and safety. These disclosures

Voluntarily highlighted human capital management efforts

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Workforce diversity</td>
<td>50%</td>
</tr>
<tr>
<td>Workforce compensation</td>
<td>34%</td>
</tr>
<tr>
<td>Culture initiatives</td>
<td>22%</td>
</tr>
<tr>
<td>Workforce health and safety</td>
<td>22%</td>
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<tr>
<td>Workforce skills and capabilities</td>
<td>22%</td>
</tr>
<tr>
<td>Workforce stability</td>
<td>6%</td>
</tr>
</tbody>
</table>
included topics such as employee health and wellness resources and benefits, and, in some cases, safety metrics for the company and its suppliers.

- Less than half of the companies that discussed workforce health and safety disclosed any related KPIs. Among those that did, the most common were recordable injury rates and the number of employees participating in certain health and wellness programs. However, only a handful of companies provided quantitative results for their disclosed KPIs.

**Workforce skills and capabilities** – 22% of companies mentioned initiatives related to employee re-skilling, training and leadership development programs and related resources. The level of detail provided around these programs varied.

- Half of the companies that discussed workforce skills and capabilities provided at least one related quantified KPI measure. This information generally included the aggregate amount of money or employee hours invested in training programs, or the number of employees participating in internal training or career planning programs.

**Workforce stability** – a handful of companies provided observations regarding the stability of their workforce.

- Most of these companies noted employee engagement scores and certain turnover rates (e.g., turnover rate for high-performing personnel) as KPIs; few provided quantified results for their KPIs.

**Disclosures relating to board oversight of human capital and culture**

We found that most companies do not specify how the board and its committees allocate oversight of various dimensions of human capital or culture. Just over 40% of the Fortune 100 broadly stated that the board oversees human capital management or culture, but it was not always clear what specific topics (e.g., workforce diversity, learning and development, or recruitment and turnover) are encompassed by that oversight.

At most companies, we found human capital and culture-related oversight responsibilities assigned to various committees based on their respective areas of focus (e.g., the audit committee often oversees compliance with employee codes of conduct while the compensation committee may oversee pay equity), but it was unclear whether these responsibilities reflect the complete picture of the board’s oversight in this space.

Overall, we found that proxy disclosures would benefit from more specificity around what dimensions of human capital management and culture are overseen by the board and how the board is executing that oversight.

**Many boards seek directors with human capital-related expertise**

Nearly a third of companies included human capital-related experience among the skills and areas of expertise sought at the board level. In describing this desired expertise, these companies used phrases and terms such as human capital management experience, talent or workforce management or development, or experience in building values-based ethics and compliance programs.

More companies (44%) cited human capital-related experience in at least one director biography in describing the key reasons that a person is qualified to serve on the board. The backgrounds of these directors vary. Some disclosures point to a candidate’s recognized leadership in diversity and inclusion, experience in shaping culture initiatives or background in human resources. Others cite human capital and culture experience related to executive leadership, scaling businesses, mergers and acquisitions, and service on other boards, among other factors.

Proxy disclosures would benefit from more specificity around what dimensions of human capital management and culture are overseen by the board and how the board is executing that oversight.
Emerging frameworks and KPIs for human capital and culture disclosures

Companies seeking to enhance how they measure and report on human capital and culture may look to a variety of market-driven frameworks that support the redefinition and communication of corporate value through an expanded stakeholder lens. The following groups, for example, have created frameworks for measuring and reporting on long-term value, in each case identifying human capital as a leading driver. For example:

• The **Embarkment Project for Inclusive Capital** (EPIC), which was formed by the Coalition for Inclusive Capitalism and Ernst & Young LLP, convened more than 30 global capital markets leaders to develop a standardized, material and comparable set of nonfinancial metrics for the measurement of company activities related to long-term value. Talent was identified as a key driver of long-term value, and EPIC proposed metrics and narrative disclosures to help guide related company reporting.²

• The **SASB** is an independent body that has published a set of detailed, industry-specific standards intended to enable companies to manage, measure and report on sustainability factors that drive value and affect financial performance. SASB’s standards are organized into five groups, one of which is human capital.

• The **Global Reporting Initiative** (GRI) is an independent international organization that helps businesses and governments understand and communicate their impact on sustainability issues such as climate change, human rights, governance and social well-being. The GRI Standards cover human capital topics such as recruitment and retention, labor and management relations, health and safety, training and education, diversity and pay equity.³

• **International Standards Organization** (ISO) is an independent, nongovernmental international organization that develops voluntary, consensus-based, market-relevant international standards. ISO 30414:2018 provides guidelines and metrics for human capital reporting, including diversity, organizational cultural, health and safety, recruitment and turnover, skills and capabilities, and more.⁴

These frameworks suggest KPIs that companies may use to better communicate human capital value. The KPIs generally correspond to those articulated by commenters on the SEC’s concept release and the Human Capital Management Coalition 2017 rulemaking petition to the SEC, which are discussed in the Regulatory developments section that follows.

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Companies using these external frameworks to provide human capital and culture disclosures may help enable comparability and avoid the perception that their disclosures lack substance. Further, companies that integrate data-rich human capital disclosures (as well as substantive disclosures related to other long-term value drivers) into public reporting beyond CSR and sustainability reports may more consistently and comprehensively communicate how the company is creating long-term value.

In today’s business environment, integrating information around long-term value drivers such as human capital and culture across company communications is increasingly important. A diverse and growing group of market participants view responsible corporate citizenship and increased attention to stakeholder interests — especially employees — as consistent with, and perhaps even critical to, creating long-term shareholder value. The Business Roundtable’s August 2019 statement on corporate purpose is among the most recent examples of these shifting dynamics.

**Regulatory developments**

In addition to market-driven reporting developments, regulatory developments may also drive changes in how human capital and culture is managed, governed and disclosed.

**Human capital**

For several years, the SEC has been working to make its disclosure requirements more modern, streamlined and effective. One area of focus has been on required business and financial disclosures. The business disclosures include, among many other topics, a requirement that registrants disclose the number of people they employ. This was and still is the only specific business disclosure requirement directly related to human capital.

In 2016, the SEC issued a concept release to solicit comment on the information investors need to make informed investment and voting decisions and whether certain of its rules had become outdated or unnecessary. In response, the SEC noted that it had received comments advocating for expanded human capital disclosures in the following areas:

- Worker recruitment, employment practices and hiring practices
- Employee benefits and grievance mechanisms
- “Employee engagement” or investment in employee training
- Workplace health and safety
- Strategies and goals related to human capital management and legal or regulatory proceedings related to employee management
- Whether employees are covered by collective bargaining agreements
- Employee compensation or incentive structures

“The historical approach of disclosing only the costs of compensation and benefits often is not enough to fully understand the value and impact of human capital on the performance and future prospects of an organization.”

SEC Chairman Jay Clayton

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In July 2017, the SEC received a rulemaking petition7 from the Human Capital Management Coalition, a cooperative effort currently involving 28 institutional investors representing more than $4 trillion in assets, to require registrants to disclose information about their human capital management policies, practices and performance, including in categories such as:

- Workforce demographics
- Workforce stability or turnover
- Workforce composition – such as temporary, contract or migrant
- Workforce skills and capabilities
- Workforce culture and empowerment
- Workforce productivity
- Human rights commitments and their implementation
- Workforce compensation and incentives

Comment letters filed in support of the petition asserted that human capital management is important in assessing the potential value and performance of a company over the long term and that companies with poor human capital practices might face operational, legal and reputational risks, while companies with strong human capital management may develop a competitive advantage.

In March 2018, the SEC Investor Advisory Committee (IAC) issued a recommendation8 to the SEC that echoed this support for expanding human capital disclosures.9 The recommendation notes that the financial markets view human capital as a source of value for companies and that institutional and retail investors want information about how companies approach human capital management, but the current accounting treatment of and disclosure requirements relating to human capital may not reflect this. The IAC encouraged the SEC to explore the possibility of including human capital disclosures in its disclosure modernization efforts.

In August 2019, the SEC proposed rule amendments to revise current business disclosure requirements, including requiring more disclosure on human capital to the extent material. Noting the history described above and that “human capital may represent an important resource and driver of performance for certain companies,” the SEC has proposed replacing the current requirement to disclose the number of employees with a principles-based requirement to provide:

A description of the registrant’s human capital resources, including in such description any human capital measures or objectives that management focuses on in managing the business (such as, depending on the nature of the registrant’s business and workforce, measures or objectives that address the attraction, development and retention of personnel).

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9 The IAC was created under the Dodd-Frank Act and has a statutorily mandated advisory and consultative role on regulatory priorities of the SEC and initiatives that protect investor interests and promote investor confidence. The SEC is required to review any findings or recommendations that the IAC brings before it, https://www.sec.gov/spotlight/investor-advisory-committee.shtml.
The SEC is soliciting comment on this proposal, and has asked whether it should provide other nonexclusive examples of measures or objectives that might be material (and thus might be disclosed), including, but not limited to, the following:

- Number and type of employees, including full-time, part-time, seasonal and temporary
- Measures regarding the stability of the workforce, such as voluntary and involuntary turnover rates
- Average hours of training per employee per year
- Measures regarding worker productivity
- Information regarding human capital trends, such as competitive conditions and internal rates of hiring and promotion
- The progress that management has made with respect to any objectives it has set regarding its human capital resources

The SEC will review comments received on this and other topics within the proposing release and consider issuing final rules at a future date.

**Culture**

The SEC has not specifically addressed corporate culture in its recent rulemaking efforts. Yet the SEC and its staff have always emphasized the importance of corporate culture and the board’s related role in setting the all-important tone at the top. The SEC has always viewed boards of directors as gatekeepers who need to exemplify and oversee good corporate governance, a rigorous compliance environment and strong corporate culture.

> The SEC has not specifically addressed corporate culture in its recent rulemaking efforts. Yet the SEC and its staff have always emphasized the importance of corporate culture and the board’s related role in setting the all-important tone at the top.
Increasing investor engagement on human capital and culture

Investor attention to and engagement on human capital and culture have increased in recent years and will likely continue to grow, increasing the pressure on companies to strengthen their practices and disclosures in this space. Some of the world’s largest money managers have recently turned their focus to human capital. BlackRock, for example, began including human capital management (HCM) as an engagement priority in 2018. It states that a company’s approach in this area is a factor contributing to business continuity and success, particularly in today’s “talent constrained environment” and in light of evolving labor market trends. BlackRock acknowledges that human capital disclosures are evolving and says it believes “in the benefit of companies moving towards a more robust disclosure of HCM metrics.” BlackRock cites the SASB, discussed earlier, as a provider of industry-specific human capital metrics that companies may consider.¹⁰

In 2019, State Street Global Advisors (SSGA) announced a focus on corporate culture “as one of the many, growing intangible value drivers that affect a company’s ability to execute its long-term strategy.” SSGA observes that “this is a challenging area for boards and management teams to report on.” It offers a framework as a starting point for how boards may approach this complex issue and sets the expectation that directors be able to discuss their role in influencing and monitoring culture. The framework suggests that senior management, under the board’s oversight, undertake three exercises (a comparative analysis, implementation and reporting) to align culture with long-term strategy.¹¹

Through our annual investor outreach program, the EY Center for Board Matters is hearing similar views from many investors. More than a third of the investors with whom we spoke in the fall of 2018, which included governance specialists from more than 60 institutional investors representing more than US$32 trillion in assets under management, said human capital management and corporate culture should be a top board focus, up from just 6% three years ago. Most of these investors told us that, at least for now, they are prioritizing dialogue over specific disclosure requests and generally seek to better understand how boards are engaged and exercising oversight in this space. As with companies, investors are on a learning curve in understanding how leading practice is evolving and what disclosures would be most valuable for assessing long-term value creation.

The Human Capital Management Coalition, which submitted the 2017 SEC petition for rulemaking, also continues to engage companies and other market participants with the aim of understanding and improving how human capital management, encompassing desired company culture, contributes to the creation of long-term value. The group has worked for years to elevate human capital management as a critical component in company performance.¹²

“Some of the world’s largest money managers have recently turned their focus to human capital.


What comes next?

Company disclosures – as well as board and management practices – regarding human capital and culture are poised to evolve further. From the growing market focus on how companies are creating value for multiple stakeholders, to investors seeking increased comparable data and transparency on these topics, to the SEC proposing to make human capital management a new disclosure topic, changes are on the horizon for how companies manage, oversee and communicate around human capital and culture.

What does this future hold? Disclosures and company practices will likely continue to be impacted by trends around technology and demographics. A preferred disclosure framework is likely to emerge, with commonality among the KPIs communicated (especially within industries). Boards will likely develop a stronger relationship with the chief human resources officer (CHRO) and continue to redefine the scope of their oversight of this space. And companies are likely to further integrate disclosures on human capital, culture and other long-term value drivers across a variety of reports beyond CSR or sustainability reports.

The benefits of such developments could be substantial and include stakeholders, particularly shareholders, being better positioned to support the company’s long-term human value proposition as short-term challenges emerge.

Questions for the board to consider

• Does the board set the tone at the top regarding the strategic importance of human capital and culture by dedicating the appropriate level of time and attention to these topics, including at the full board and committee levels?

• Does the board have the right composition and resources to appropriately oversee culture and talent management in the wake of disruptive talent trends and transformation?

• In today’s information age, where the role of the CHRO is akin to the role of the CFO through the industrial age, is the board spending enough time meeting with the CHRO to oversee talent strategy and performance?

• Is the company communicating its culture and values across the workforce such that each individual employee fundamentally understands how her or his day-to-day responsibilities and performance drive strategy and align to the company’s purpose?

• Is the board regularly reviewing with the CHRO talent and culture metrics similar to its quarterly updates on financial metrics with the CFO? How is the company integrating human capital metrics and performance into earnings calls, analyst meetings and its external financial reporting to better communicate long-term value?

• How are culture and talent goals integrated into incentive compensation programs? How is the company monitoring and adjusting for any unintended consequences?
Better Questions for Boards
Webcast series

Our series is designed to provide directors with insights and questions to consider as they engage with management on a variety of complex boardroom issues. You can access on-demand replays to hear insightful discussions about how boards are approaching a variety of issues.

Why boards are the key to communicating long-term value
Corporations are better able to deliver long-term value to shareholders when they understand and address the needs of their customers, employees, investors, regulators and other key stakeholders. The evolving discussion around that view anchored our recent webcast in which panelists highlighted ways boards can better communicate how their companies are creating long-term value for a wide set of stakeholders. They discussed methods for identifying, measuring and reporting on key drivers of long-term value and considered recent market-driven approaches and regulatory views on quantifying and communicating corporate value with an expanded and longer-term perspective.

How to enhance cybersecurity risk oversight
Our second annual national Cybersecurity Board Summit brought together board members representing a cross-section of industries, geographies and sizes for discussions on cybersecurity risk and oversight. The summit was the culmination of a series of six regional director dialogue dinners. In this webcast, we share some of the key takeaways from what we heard from more than 100 directors, and discuss evolving leading practices, recent lessons learned and how boards can enhance cybersecurity risk oversight.

How is your board overseeing culture and talent strategy in today's information age?
As new paths to innovation become increasingly critical for long-term growth, talent and culture have leapt to the forefront of thinking around enabling strategy and creating long-term value. As a result, board oversight of culture and human capital is rapidly evolving. In this webcast, we explore the strategic importance and rising value of culture and human capital. We also discuss emerging trends that are shaping talent and the future of work – and the ways leading boards are sharpening their oversight of culture and human capital management.

Access any of our on-demand webcasts at ey.com/us/boardmatters.
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About the EY Center for Board Matters

Effective corporate governance is an important element in building a better working world. The EY Center for Board Matters supports boards, committees and directors in their oversight role by providing content, insights and education to help them address complex boardroom issues. Using our professional competencies, relationships and proprietary corporate governance database, we are able to identify trends and emerging governance issues. This allows us to deliver timely and balanced insights, data-rich content, and practical tools and analysis for directors, institutional investors and other governance stakeholders.

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